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HOW TO MAKE MONEY FROM FAILING S&Ls

NEW TAX PITFALLS FOR CORPORATE THRIFT PLANS

APRIL 2, 1990

THREE DOLLARS SEVENTY-FIVE CENTS

Forbes

PHILIP MORRIS' ACQUISITIVE HAMISH MAXWELL

WHO'S NEXT?

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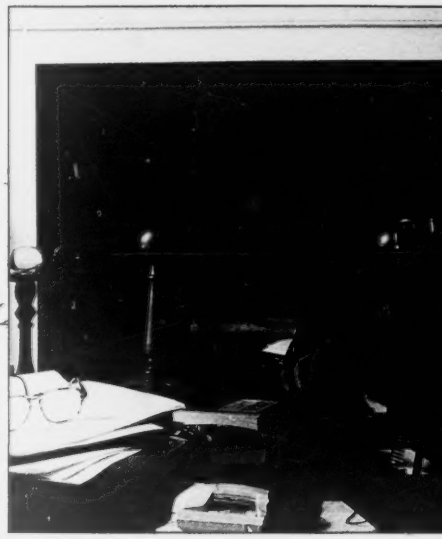
Forbes

96 Cover illustration by Alan Reingold

37 *DLJ, junk dealer*



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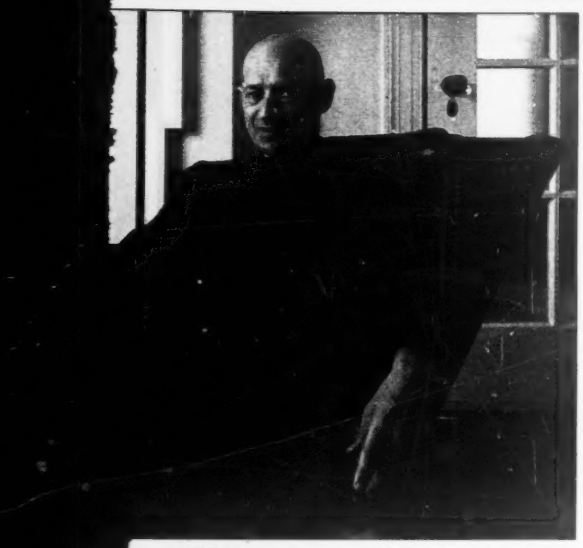

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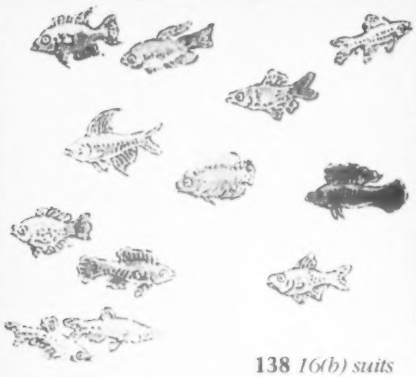

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Forbes Informer

Edited by Eric Schmuckler

Newhouse vs. IRS, round two

Illustrations by Laura Gornell

Fresh from their $600 million court victory over the IRS in the tax battle over their father's estate, media magnates S.I. and Donald Newhouse now face another round with the feds. This time it's over the value of stock in the family businesses left by founder S.I. Newhouse to his wife, Mitzi, who died last June.

In the first case, the family contended that S.I. Sr.'s stake in the Newhouse private media empire was worth $247 million when he died in 1979; the IRS pegged his share at $1.3 billion. A tax court judge agreed with the Newhouses in late February.

In late 1988, just before the father's estate case went to trial, the IRS announced it was disputing the values Mitzi had placed on stock left her by S.I. Sr. and asked for more than $300 million in back taxes, plus $15 million in penalties. The Newhouses dispute the entire claim and say they owe nothing.

The judge rejected the government's valuations in the estate case and many of the same issues and values come into play in the Mitzi case. Even Robert Shilliday, top gun on the IRS side, concedes that the estate ruling will cause "a lot of difficulty" in pressing the Mitzi claim. But no early resolution is in sight. The government is still trying to decide whether to appeal the brothers' victory.

Cohen and Cogan: together again

Peter Cohen, 43, who was forced out recently as chairman of Shearson Lehman Hutton, isn't nursing his wounds. He's already set up camp for his next move. He has moved into the 59th-floor aerie of Manhattan's Citicorp Building, sharing space with his old mentor, Marshall Cogan. Cogan, chairman of Knoll International and owner of New York's famed "21," was Cohen's immediate boss in the early Seventies at Cogan, Berlind, Weill & Levitt, the securities firm Sanford (Sandy) Weill built into the Shearson colossus.

Cohen likes to reminisce about those days, especially about how he wondered what would happen to him when Cogan left the old firm after losing a power struggle to Sandy Weill. But Weill wound up taking Cohen to lunch and told him he wanted the young man's help in building the firm into a Wall Street powerhouse.

Will Cohen and Cogan join forces again? Neither could be reached for comment. Word is that for now Cogan is just helping his pal out with office space. But it woudn't surprise us if they did a deal or two together one of these days.

Son of Swink

'Twas the Wednesday after Christmas that Swink & Co., a junk municipal bond house in Little Rock, Ark., abruptly closed its doors last year. Few folks wept over its demise: Swink was a big seller of high-yielding municipal bonds that had a nasty habit of defaulting shortly after their issuance.

But the need to sell bonds apparently runs deep in Swink blood. In early March, First American Securities, a seller of—you guessed it—high-yield municipals, opened for business in the same offices that housed Swink & Co. Who's in charge? None other than Jim Swink Jr. Interestingly, after Swink went under, state regulators made firm principal Jim Swink Sr. sign a letter agreeing not to participate in any way with the new firm. But, as luck would have it, big Jim has set up shop just down the hall.

Guess Big Jim's regulatory agreement did not prohibit him from giving junior a few tips from time to time.—**Gretchen Morgenson**

Meyer's big gun

Who did penny stock scamster Meyer Blinder call when he found himself indicted on 11 criminal counts of securities and wire fraud in February? None other than Washington lawyer Brendan Sullivan, the same guy who defended Lieutenant Colonel Oliver North in the Iran-contra case. Blinder, who has a nasty habit of doing widows and orphans and other innocents out of their hard-earned money in security scams, is unlikely to attract the popular support Ollie North got. But neither is Meyer going to need to appeal to his friends and supporters to pay his bills.—**Claire Poole**

Take the money and run

Thanks to various campaign finance "reform" bills, 191 current members of the House of Representatives can just pocket their leftover campaign funds if they stand down by the 1992 election; they forfeit their conversion rights if they want to stay in Congress after that. We owe this insight to Mark Melcher of Prudential-Bache Securities, who keeps track of such things. He figures that because of this "conversion window" we may well see a bigger than expected turnover in Congress in the next couple of years. Which House members are sitting on the largest potential nest eggs? Check out the list below.

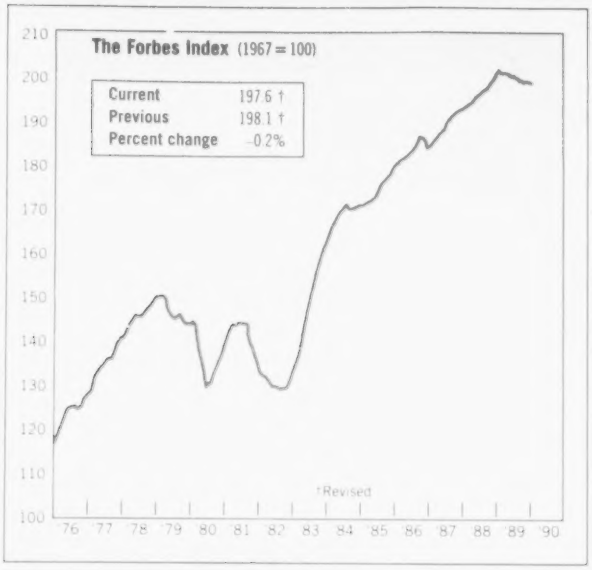
Congressional kitties

House members with the largest convertible campaign funds, as of Nov. 1988. These nest eggs have likely swollen some since then.

Stephen Solarz (D–NY)	$1,169,371
Dan Rostenkowski (D–Ill)	1,036,513
Ronnie Flippo (D–Ala)	811,379
Matthew Rinaldo (R–NJ)	757,226
James Quillen (R–Tenn)	714,450
Robert Matsui (D–Calif)	651,878
Bill Archer (R–Tex)	637,808
Carlos Moorhead (R–Calif)	619,378
Sam Gibbons (D–Fla)	616,950
Larry Hopkins (R–Ky)	604,822

Source: Congressional Quarterly

The Forbes Index



Tax reform and a slowing economy haven't yet convinced American consumers to lighten their debt loads. Although personal income gained 0.6% from December's revised total to a new high of over $2.7 trillion (annualized), consumer installment credit rose 1.1% during the period. That's the sharpest month-to-month increase in consumer debt in a year. If stiff, almost completely nondeductible interest on credit card debt isn't a motivation to pay cash or go without, perhaps nothing is. Final figures show the Forbes Index declined 0.5% in 1989.

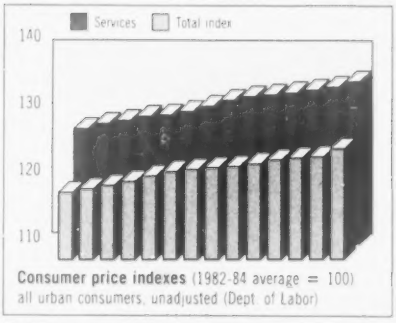
Other key rates	Source	Status
Prime rate	Chase Manhattan Bank	10.0%
Auto sales[1] year to date vs. 1989	Ward's Automotive	1.3%
Index of leading indicators January vs. December	Dept. of Commerce	0.0%
Trade balance last 12 months	Dept. of Commerce	-$108 bil
Producer price index[2] January vs. 1989	Dept. of Labor	5.8%
GNP 4th quarter vs. 3rd—annualized growth	Dept. of Commerce	0.9%†
NBER Experimental Recession Index[3]	Natl Bureau of Economic Research	3.0%

[1]U.S. based manufacturers only as of 2/28/90. [2]Finished goods. [3]January 1990. † Revised.

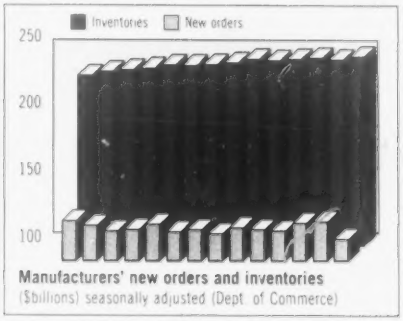
Index Components

The Forbes Index is a measure of U.S. economic activity composed of 8 equally weighted elements: Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, new housing starts, total retail sales, the level of new orders for durable goods compared with manufacturers' inventories, personal income, total consumer installment credit.

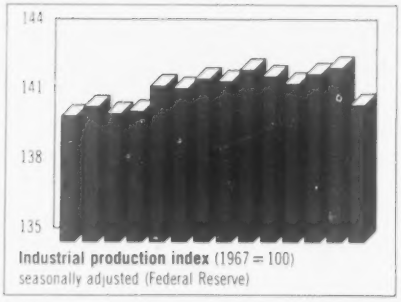
To measure these 8 elements, FORBES monitors 10 series of U.S. government data. The last 14 months' data for each series are presented below.



Consumer price indexes (1982-84 average = 100) all urban consumers, unadjusted (Dept. of Labor)

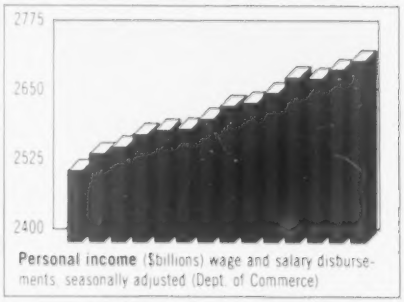


Manufacturers' new orders and inventories ($billions) seasonally adjusted (Dept. of Commerce)

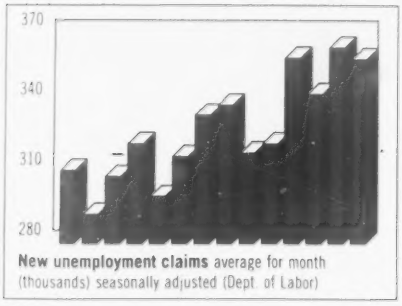


Industrial production index (1967 = 100) seasonally adjusted (Federal Reserve)

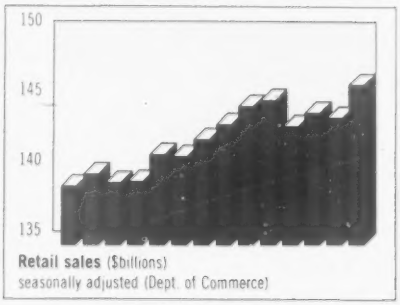
New housing starts (thousands) privately owned, unadjusted (Dept. of Commerce)



Personal income ($billions) wage and salary disbursements, seasonally adjusted (Dept. of Commerce)



New unemployment claims average for month (thousands) seasonally adjusted (Dept. of Labor)



Retail sales ($billions) seasonally adjusted (Dept. of Commerce)

Consumer installment credit ($billions) total, seasonally adjusted (Federal Reserve)

made dozens of acquisitions, financed mostly with conventional bank debt and bond offerings, and had built Tyler's sales to over $1 billion.

McKinney still remembers the excited director at the Beverly Hills conference urging him to jump on the junk wagon and do more deals. He recalls the conversation:

"Joe," argued the director, "the banks wouldn't do these deals if they didn't hold water." Replied McKinney: "If you evaluate deals based on what the banks will lend on, you're in trouble."

Not long after his director tried to get him to buy more assets, McKinney decided it was time to sell. By the time his most recent asset sale is completed this spring, if all goes as planned, he will have sold off more than four-fifths of Tyler and distributed to shareholders some $415 million, around $21 in cash and acquirers' stock per Tyler share. Not a bad return on a stock that was (and currently is) trading at 9 or so before McKinney started unloading assets.

His strategy was in part defensive. In 1987, when takeover fever had become epidemic, Tyler had operations in electronics distribution, specialty coatings, explosives and cast-iron pipe and fittings for the construction industry—just the kind of collection of salable assets the raiders were looking for. McKinney: "Our stock was at 9 to 10 and was worth 22. The thought of a raider popping a deal on us at 15 was to me very repugnant."

Why not organize an insiders' buyout and capture the value difference for management? McKinney, who owns 5% of Tyler's equity, turns up his nose. "From the moment you make that decision, you put yourself on the other side of the table from the stockholder, and he's the guy you're working for."

Instead, McKinney began selling Tyler Corp.'s pieces in the junk-bond-fueled asset market. First to go, in August 1988, was Tyler's electronics distributor, Hall-Mark Electronics, sold to its management. McKinney paid out most of the $211 million net cash proceeds to shareholders as a special $10-a-share dividend.

Unfortunately, the dividend from Hall-Mark was taxable that year. Not so the proceeds from McKinney's next sale. A year later he sold Reliance Universal, Tyler's specialty coatings maker, to Akzo, the Dutch chemical conglomerate, in a deal worth $268 million. In this so-called Morris Trust transaction, McKinney put the assets he wanted to keep, the explosives and pipe and fittings operations, into a subsidiary and spun that off to shareholders, tax-free. What was left—call it "old Tyler"—was Reliance, plus $165 million worth of Tyler's debt. Then Akzo swapped stock worth $103 million for old Tyler; the Akzo stock, $4.86 worth per Tyler share, was distributed to Tyler shareholders, who won't pay tax on the Akzo stock until they sell it.

McKinney is preparing another Morris Trust transaction. This involves selling Tyler's Atlas Powder unit, the U.S.' largest maker of explosives, to Britain's Imperial Chemical Industries. The deal, valued at $193 million, should close in late spring.

What will be left? Tyler, virtually debt-free, will be down to Tyler Pipe, the pipe and fittings maker, which had $189 million in sales last year.

Tyler stock currently trades at about 8¾. Assuming the ICI deal closes as planned, Tyler shareholders will get ICI stock worth $6.16 per Tyler share. That values Tyler Pipe at about $2.50 a share, or 3 times the rump company's pro forma operating cash flow. Bradley Purcell, an analyst who works with investment manager Mario Gabelli (whose funds own 9% of Tyler), figures that Tyler will trade at about 4.5 times cash flow, or 3½, after the deal. If the ICI deal falls through, Tyler will likely drop back to 5 or so a share.

Assuming the deal gets done, McKinney will be ready to start rebuilding Tyler again, now that so many of the late 1980s leveraged deals are coming unstuck. "If a company defaults," he says, "then its senior lenders can sell it for, say, the 40 cents on the dollar that would cover them and allow them to escape criticism from the bank examiners." He says he's looking for "the Tyler kind of company—drab, nonglamorous, fairly low-growth, with a dominant industry position, well managed, that in return for the negatives throws off cash that we can use to improve its position in its industry and also make additional acquisitions."

McKinney hopes to pay no more than five times operating cash flow. The Tyler units McKinney sold went for nine to ten times cash flow. McKinney's message: Sell high, buy low, get rich. But above all, think for yourself. ■

After Drexel, no other Wall Street firm has so many of its eggs in the junk bond basket as Donaldson, Lufkin & Jenrette. Yet no one expects DLJ to go under.

It's nice to have a sugar daddy

Chas. B. Slackman

By Marcia Berss

Joe Roby, the burly chief of investment banking at Donaldson, Lufkin & Jenrette, doesn't buy the common wisdom that the junk bond business is finished with the demise of Drexel Burnham Lambert. Says Roby: "We would be glad if all our competitors got out of the high-yield business."

Where others see only blood on the floor, Roby sees opportunity for his

DLI's head of high-yield operations, Garrett Moran
"Product that makes sense will still get done."

firm in junk bonds—high-yield securities, the practitioners prefer to call them. "There has been significant structural damage done to the high-yield marketplace," he says. "It's in disarray. But it's like the over-the-counter stock market in 1974-75. It went through all the same agonies. People pronounced it dead. Three years later, folks couldn't get enough of it."

DLI is putting its money where its mouth is. As a percentage of business, only Drexel among major firms was more committed to junk bonds than this subsidiary of the $58 billion (assets) Equitable Life Assurance Society of the U.S. *(see table)*. Other surviving firms may do more junk underwriting measured in total dollars. In 1989 First Boston had 8% of the high-yield new issue market, for example, while DLI took 5%. But junk bonds were 29% of DLI's underwriting business, versus only 5% at First Boston. And DLI's junk bond exposure doesn't stop at underwriting. It is one of the top three firms trading junk bonds in the secondary market.

That DLI has not been frightened away from junk deals was demonstrated in February when (with brokerage house Smith Barney) it took on the refinancing of $1.7 billion in increasing interest rate loans for William Farley's leveraged buyout of textilemaker West Point-Pepperell (FORBES, *Jan. 8*)—a deal many on Wall Street believe is doomed.

This at a time when DLI is still holding a $295 million bridge note out to Vitro S.A., for example, part of the big Mexican glassmaker's purchase of Anchor Glass Container Corp. last year. Vitro pays DLI 5% over the prime rate for the loan. DLI also holds a $110 million bridge loan that financed the management buyout of Rhode Island-based GTech Corp., a provider of computerized services to government-sponsored lotteries. DLI points out that GTech's cash flow is a very healthy two times its interest expense on the loans. (Prior to the junk market's crash, many deals were done at 1¼ to 1½ times cash flow.)

DLI has no illusions that GTech and the other deals can be refloated through public offerings of junk bonds to the mutual funds, insurers, S&Ls and other former junk bond customers. It expects to use instead private offerings, where it will deal with highly sophisticated lenders who are not worried about interim fluctuations because they can hold the bonds to maturity. This ability to hold to maturity is important because many junk bond holders like First Executive Corp. are in trouble precisely because they must constantly mark the bonds to market. "In private placements, the buyer is only relying on the credit [worthiness of the issuer], not the credit and the bond market," notes Garrett Moran, the 35-year-old head of high-yield operations at DLI. He adds: "Product that makes sense will still get done."

Some Wall Streeters question whether Bill Farley's West Point-Pepperell deal is product that makes sense. DLI, clearly, doesn't share this view. Farley, a former Drexel client, in 1989 paid $2.7 billion to buy the sheet- and towelmaker. The deal is in trouble because asset sales to raise cash and retire debt are yielding less than expected. At the same time, West Point's customers, big department stores, are reeling from leveraged buyout woes.

DLI got the Farley deal, beating out American Express' Shearson Lehman Hutton. One investment banker familiar with the transaction chalks DLI's win to the sugar-daddy factor. The rumor is that DLI's very rich parent, Equitable, committed itself to providing Farley a bridge loan should his current bridge loan holders—Wells Fargo Bank and Bankers Trust—want to bail out. DLI strongly denies any such side commitment. If it was given, it would have been a real plus for DLI in landing the business at a time of tremendous uncertainty in deal financing.

Maybe it is because he knows that Equitable stands behind DLI that Joe Roby can say with confidence: "High-yield will be back." He's almost certainly right, of course; markets always go to extremes, and the time to get in is when everybody else is getting out. The player with staying power is the one that wins the game. ■

Deep in junk

In the 1980s Donaldson, Lufkin & Jenrette's commitment to junk debt trailed only Drexel's.

Firm	Junk debt underwritings 1980-89*
Drexel Burnham Lambert	57.6%
Donaldson, Lufkin & Jenrette	27.0
Prudential-Bache	7.9
Bear, Stearns	7.8
Morgan Stanley	7.8
Merrill Lynch	6.5
First Boston	6.1
Shearson Lehman Hutton	5.9
Smith Barney, Harris Upham	5.9
PaineWebber	5.7
Kidder, Peabody	4.9
Salomon Brothers	3.9
Goldman, Sachs	3.7
Dean Witter	3.2

*As a portion of firm's domestic underwritings.
Source: IDD Information Services

The Forbes Wall Street Review

Edited by Eric S. Hardy

What might keep the market from heading higher? Debt, says Charles Allmon, a very conservative money manager whose $125 million (net assets) Growth Stock Outlook Trust has been 65% or more in cash since it was founded in 1986. Allmon favors companies with clean balance sheets, and can't find very many at good prices these days. He expects that a credit crunch will soon force long Treasury bond yields up to the 9¾%-to-11% range, from about 8½% currently.

Allmon is doing some selective stock buying, but not in the U.S. Recent purchases include Nestlé (Switzerland), Deutsche Bank (West Germany) and Glaxo Holdings (U.K.). The proportion of foreign stocks in his portfolios has risen to 10%.

For U.S. stocks in general, February proved to be a much better month than January, and the momentum carried over into the first part of March. But trading volume deteriorated somewhat in February. On the New York Stock Exchange the average daily volume was 156 million shares, down 10% from January.

During the two weeks ended Mar. 8, the Dow industrials picked up about 120 points, or 4.7%, to get within a hair's breadth of 2700. The Wilshire index of 6,000 common stocks gained about 4% during this period. If the market keeps rising, and if Allmon is right about a credit crunch ahead, the correction could be nasty.

The overall market[1]

The Best Performing Stocks

Company	Price	2-week change	P/E	Avg vol (thou)[2]	Rel vol[3]
MGM/UA Communications	17⅛	51%	NA	2,135	4.1
Wang Laboratories	6	50	NA	4,876	1.8
Adobe Systems	38¼	41	25	9,222	3.0
Contel Cellular	23½	32	NA	728	1.1
TJX	16⅛	23	14	1,905	0.9

The Worst Performing Stocks

Company	Price	2-week change	P/E	Avg vol (thou)[2]	Rel vol[3]
C R Bard	13⅛	-23%	12	7,058	4.7
Hilton Hotels	50⅜	-21	22	2,140	0.6
LIN Broadcasting	86½	-21	NA	5,954	1.1
FHP	16½	-20	15	4,725	1.8
Lyondell Petrochemical	17⅜	-13	4	1,352	1.1

Closeup on the Market

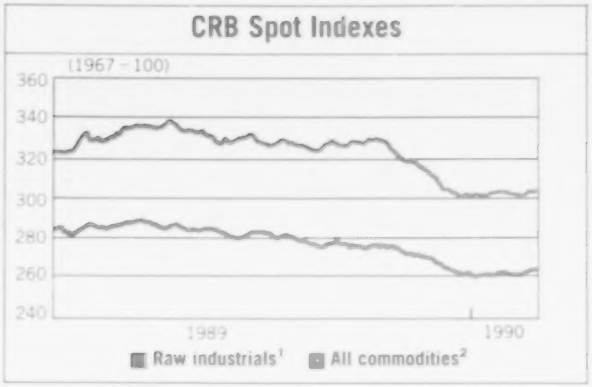
Index or investment	Price	2-week change
Wilshire index 6,000 stocks, capitalization weighted	3,281.11	3.9%
Wilshire index 6,000 stocks, equal weighted	21.37	3.0
Dow Jones industrials 30 stocks, divisor-adjusted price average	2,696.17	4.7
S&P 500 Capitalization weighted cross section, major stocks	340.27	4.5
NYSE Capitalization weighted, all listed common stocks	187.35	3.9
Amex Capitalization weighted total return stocks, warrants	361.51	2.3
Nasdaq Capitalization weighted, all issues except warrants	436.50	3.3
Amex international market index Capitalization weighted, 50 largest ADRs	307.74	-2.7

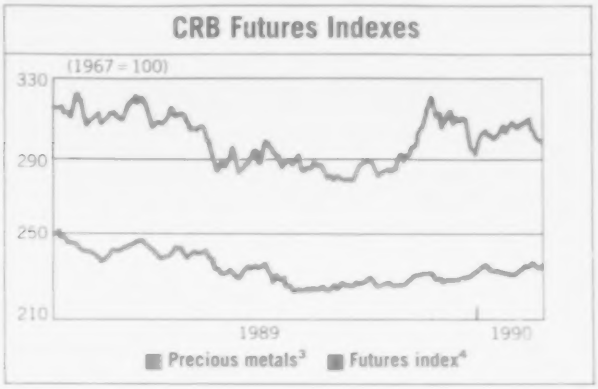
Index or investment	Price or rate	2-week change
Europe, Australia, New Zealand and Far East[4] (EAFE) a dollar denominated capitalization weighted index	918.80	-4.9%
Institutional[5] Approximately 200 stocks with high institutional ownership	113.48	5.4
Individual[5] Approximately 200 stocks with low institutional ownership	104.43	1.1
Russell 2000 index 2000 stocks with small market values, capitalization weighted	162.07	2.7
Gold[6] (Composite quote of 6 major dealers)	$402.50	-3.7
Yen[6] (per $U.S.)	151.15	3.2
Commodity index[6] (CRB futures index: 1967 = 100)	238.97	1.2
Oil[6] (W Texas Intermediate)	$20.80	-4.4
T Bills[6] (90 days)	7.89%	5 basis points[7]
Broker loan rate[6]	9.25%	unchanged

Note: All data for periods ending 3/8/90. Wilshire index reflects price performance. It differs slightly from market value of outstanding stocks because of retirements of equity since index was created. Stocks listed above have market capitalizations of $500 million or more. [1]Capitalization weighted, prepared by Wilshire Associates, Santa Monica, Calif. [2]Average daily volume over a 2-week period. [3]Average daily volume over the last 2 weeks, divided by the average daily volume over the preceding 3 months. [4]Morgan Stanley Capital International Perspective. [5]For period ending 3/9/90. A. Arbel, Cornell University, using Ford Database from Ford Investor Services. [6]Knight-Ridder Financial Information. [7]A basis point is equal to one-hundredth of a percentage point. NA: Not applicable.

Commodities Review

Edited by Eric S. Hardy



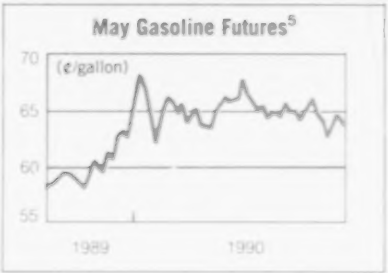


The Commodity Research Bureau futures price index rose 2% in the first two months of the year, reaching its highest point since July 1989. Besides anticipating price changes in a basket of 21 commodities, this index is sometimes used by commodity traders (and other amateur and professional economists) to predict changes in the inflation rate and interest rates. William Byers, who follows commodities for Bear, Stearns, says there is sometimes a correlation between the CRB index and subsequent action in the credit markets. Although the index is useful for predicting commodity price trends, adds Byers, it gives too much emphasis to items such as grains and soybeans to give a good macroeconomic forecast.

For inflation forecasting purposes, the CRB index may be a victim of its own accuracy. James Nevler, an analyst with Knight-Ridder Commodity Research Bureau, points out that because inflation fighting has become such a high priority, the Federal Reserve will routinely act even when there are the slightest expectations of higher inflation. For example, in 1987 the CRB index rose dramatically, as did interest rates a few months later.

As a result, price increases predicted by indexes such as the CRB may never materialize. It's a sort of self-denying prophecy. "The CRB was a better forecasting tool back in the 1970s because the Fed waited longer to take action," says Nevler.

Commodity Spotlight



Environmental laws compel refiners to lower the vapor pressure of gasoline during warmer months to reduce air pollution. May is the first month of the season when fuel must meet these standards. Because of intense speculation about whether supplies of low-vapor pressure gasoline will be adequate for the summer driving season, the May futures contract has been as volatile as a hot can of gas.

Cash and Futures Prices

Spot Indexes			Futures Indexes		
Index[6]	Value	3-mo change	Index[6]	Value	3-mo change
All commodities	264.00	–1%	CRB Index	234.59	3%
Raw industrials	303.94	–1	Precious metals	299.61	–5
Metals	294.55	–3	Industrials	251.71	–1
Textiles	242.34	–3	Grains	196.60	–4
Foodstuffs	215.22	1	Livestock & meat	212.54	–1

Spot Commodity Prices			Futures Prices		
Commodity	Price	3-mo change	Commodity	Price	3-mo change
Steel scrap ($/short ton)	$101.00	5%	April platinum ($/troy oz)	$508.00	–3%
Copper scrap (¢/pound)	85.00	–5	April crude oil ($/barrel)	21.54	9
Print cloth (¢/sq yard)	71.00	–4	May copper (¢/pound)	108.25	4
Corn (¢/bushel)	241.00	4	May cotton (¢/pound)	70.16	–3
Soybean oil (¢/pound)	21.80	14	May Chi wheat (¢/bushel)	362.25	–7

Notes: All data as of 2/28/90. [1]Comprised of 13 commodities. [2]Comprised of the 13 raw industrial commodities plus 10 foodstuffs. [3]Gold, platinum and silver. [4]Comprised of 21 commodities. [5]Prices from 12/1/89 through 3/7/90. [6]Base for spot and futures indexes (1967 = 100). Source: Knight-Ridder Commodity Research Bureau